NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

AFFILIATED WITH SERVICE EMPLOYEES INTERNATIONAL UNION, AFL/CIO

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STATEMENT OF
THE NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

BEFORE THE
COMMITTEE ON POST OFFICE AND
CIVIL SERVICE

OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

March 6, 1984

Mr. Chairman, the National Association of Government Employees, which is an affilliate of the Service Employees International Union(AFL-CIO)is pleased to have this opportunity to present our views to the Committee on the development of a retirement system for employees who are subject to Social Security. We applaud the Chairman and the full Committee for their leadership, and foresight in commencing early considerations on this complex and important topic.

The development of a retirement system for federal employees covered by Social Security is an issue of great significance to government's ability to recruit and retain quality employees for decades ahead. The design of a supplemental retirement system is a complex and sensitive task. Issues in the design, financing, level of benefits, eligibility, and coverage insure that this will be a major undertaking. The size and diversity of the federal workforce alone assures the difficulty of designing a retirement system. The Committee has recognized the complexity and importance of this project, and astutely elected to take a comprehensive approach to the design of such a system. This Committee has commissioned several studies by the Hay/Huggins Associates, the General Accounting office, and the Congressional Research Service to assure that all parties have adequate information from which to make these important decisions. Our organization has already profited from the information produced out of this Committee's efforts and its counterpart in the Senate. We look forward to the continued leadership of the Committee on the development of this issue.

The Committee has requested our position on a series of issues relevant to the design of a new system. We will at this time respond to these matters in a general manner. We look forward to analyzing the complete data from the studies the Committee has caused to be undertaken and from our own studies to develop more specific recommendations at a later date. We will however, discuss certain broad principles in the context of our testimony which we believe should be included in any supplemental plan.

BACKGROUND

As you are aware the April 1983 Social Security Amendments (PL-98-21) required all federal employees hired after January 1, 1984 to be covered by both Social Security and the Civil Service Retirement System. At the time the Social Security Amendments were passed no new Civil Service Retirement System had been designed to supplement social security for newly covered employees. With newly hired federal employees facing the hardship of paying 7% of their salary to social security and 7% to CSRS, Congress passed provisions of the Federal Physician's Comparability Allowance Amendments of 1983(PL-98-168) to address this problem. Title II of this legislation addressed this problem by allowing newly hired federal employees to make reduced contributions to CSRS and participate in that system on an interim basis. PL-98-168 expires at the end of calendar year 1985 and leaves

Congress with a tight schedule in which to resolve the many difficult and sensitive issues involved in designing a retirement system.

COMPARABILITY ANALYSIS

Pension plans are of value to both employers and employees. Pensions allow employees to leave the job with income and dignity. A sound pension system allows the employer to create advancement opportunities for younger workers and creates orderly transitions in the work force. Pensions serve as a recruitment and retention device. Workers expect to receive pensions and compare the benefits offered by competing employers. Benefit comparisons of the total benefit comparability rather than of pensions solely, are the considerations employees make in deciding on employment options. Workers will examine the total compensation package, including health and dental insurance; capital accumulation options, as well as salary levels in making employment decisions. It is thus most appropriate that the Congress also considered such factors in their comparability analysis.

Traditionally, many federal employees have regarded CSRS as a quality pension plan and a trade-off for inferior salaries. Many federal employees have been willing to eschew more generous private sector salaries for the promise of a dignified retirement. The CSRS has been government's most effective device for the recruitment and retention of quality workers. It is because of this role that NAGE believes that the supplementary retirement system should primarily compare itself with the current CSRS for purposes of comparability analysis.

In looking at private sector plans Congress should look at those employers who have similar working conditions, environments and groups of employees. As the largest single employer in the United States, the federal government's work environment and staffing needs can best be compared only with some of the largest private sector companies. It is thought that these employers will compete with the federal government for top workers. The largest companies compared should also have a similarly high percentage of administrative, technical, and professional employees.

There are currently over 500,000 pension plans in the United States with an almost equal number of pension variations. Developing a common set of economic assumptions and demographic data base will be a difficult task. The large number of companies offering capital accumulation plans will compound the difficulty of the analysis. The value of these capital accumulation devices, such as stock options could easily be underestimated. It would be easy for a party to select the data in a fashion which supports a pre-selected position. A true comparison will be more difficult to achieve.

GENERAL DESIGN

Recent changes in tax laws have created a broad array of pension options. Provisions of the Employee Retirement Income Security Act of 1974 (ERISA) provided employees for the first time with the opportunity for tax deferral of salary through the use of an individual retirement account (IRA). The Economic Recovery Act of 1981 expanded the deductible amount and availablity of IRA's and serves as an incentive to both employer and employee to utilize these options for retirement purposes. Recent rulings by the IRS have encouraged the users of the so called salary reduction or (401K) plans. These changes in the tax law are rapidly changing the pension universe.

Currently, most all pension plans are made up of one or a combination of three major pension types: defined benefit plans, defined contribution plans or individual pension plans.

A defined benefit plan provides a given benefit upon retirement based on a formula of years of service, age and salary.

A defined contribution plan provides a fixed contribution with the benefit of retirement fluctuating depending upon investment earnings.

An individual pension plan such as an IRA or KEOGH is one where the employee makes contributions and bears the risk for the investment return.

The greatest numbers of participants are in defined benefit plans. While defined contribution plans have been the fastest growing element of the pension universe they most often are being provided as a supplement to defined benefit plans. Evidence from a 1982 survey conducted by Hewitt Associates reveals that 96% of surveyed employers had a defined benefit plan. The majority of these employers also sponsored defined contribution plans.

The greatest advantage to the defined benefit plan is that the employee is assured of a fixed pension in accordance with the plan's formula. Employees are able to predict the level of benefits at retirement, and are not as risk contingent upon advances and declines in pension earnings. In defined contribution plans employees bear the risk of advances and declines in investment return. Defined contributions are frequently designed to enhance portability of benefits and its financing mechanism allows employers to predict with greater certainty its pension casts. For these reasons defined benefit plans are strongly preferred by private sector labor unions.

In addition to deciding whether to use a defined benefit plan or defined contribution plan or a combination of both, Congress must also decide whether social security benefits should be indexed to CSRS, and if so how much.

As the Committee is aware social security has income distribution features built into it. The social security benefits formula provides a higher percentage of total pre-retirement earnings to low earners than it does for high earners. Pensions can be structured in a manner to integrate with social security in such a way so that the redistributive effects of social security can be offset. The current CSRS is neutral with regard to social security. All civil service retirees with the same number of years of service, regardless of income, receive the same percentage of of their salaries. On designing the supplementary retirement system Congress must decide to either completely offset pension dollars with social security dollars, ignore the social security benefit by simply adding the pension benefit on top of the social secuity benefit, or integrate the pension with social security so as to offset part of the tilt but not all of it.

If the plan were to completely offset social security, the effect would be that lower paid federal workers would receive little of their total benefits from CSRS, and almost all their pension benefits from social security while the highest paid federal workers would receive most of their total benefits from CSRS. It is noted that the IRS rules would not qualify a plan which fully offsets social security benefits. Further, many private sector unions believe that full intergration of this sort unfairly disadvantages lower paid workers to the advantage of higher paid workers.

On the other extreme, however, if the plan were designed so that its benefits were simply added on to social security then lower income workers would receive a higher percentage income than currently received under CSRS, while higher earning workers under the new system would receive smaller retirement benefits than comparably paid employees in the current system.

The third option is to partially integrate social security with pension benefits. Integration of this sort allows the design of a pension system with replacement rates across the entire range of income levels falling between offset and add on plans. The plan could be designed to offset the social security tilt at differing levels of income.

As of this time, we are still weighing the relative merits of defined benefit and defined contribution plans, and whether and by how much social security should be offset.

ELIGIBILITY AND INFLATION PROTECTION

The current CSRS vests employees in the system after five years of service. Employees are eligible for an unreduced non-disability pension at age 55 with 30 years of service or at age 60 with 20 years of service or at age 62 with 5 years of service. In addition employees serving in the law enforcement or fire-fighting areas can retire at age 55 with 20 years of service. Pensions are computed in accordance with a formula using an employees highest three consecutive years of earnings. Pensions are indexed to the CPI with employees receiving the COLA each March. In 1982 Congress passed provision in the Omnibus Re-Concilliation Act which provided in years 1983, 1984, 1985 COLA will be effective one month later each year, and that non-disabled retirees under age 62 would receive a reduced COLA.

As we discussed earlier the Civil Service Retirement System has been the most successful benefit in attracting and retaining quality workers. The pension benefits under CSRS have been designed to provide a comfortable and dignified retirement for those who invest the longest years of work in the government. The CSRS thus provides an incentive to the most dedicated workers to remain with the government for their careers.

Traditionally many federal employees have regarded a quality pension plan as a trade-off for inferior salaries. Two of the most important elements which make CSRS a quality plan are the early retirement and inflation protection provisions. Many federal employees were willing to eschew more generous private sector salaries for the promise of a dignified retirement. No steps have been taken to close the widening comparability gap in salary and other benefits. If Congress were to diminish the quality of the supplemental retirement system at this time the effect on the work force would be devastating. The government's ability to recruit and retain workers with offers of inferior wages, inferior insurance benefits and inferior retirement benefits would be minimal at best.

The NAGE believes that the supplementary retirement plan must provide comparable levels of benefits to the current CSRS. Members of the House leadership in a February 18, 1983 letter signed by Speaker O'Neil, and Chairman Ford, and Chairman Rostenkowski have indicated support for a supplemental plan which provides comparable benefits and costs as currently provided under CSRS. We strongly endorse this concept. Congress must maintain comparable benefit levels if it wishes to continue to attract the quality of federal workers needed to accomplish the government's mission in the decades ahead.

The Committee has asked for our opinion of whether the new retirement system could be changed to reduce costs through restructuring of the inflation protection provisions in exchange for an improved thrift plan or other capital accumulation plan.

NAGE strongly supports the full inflation and early retirement provisions of the CSRS. We are aware however that social security is indexed to inflation and that a thrift plan could provide increased portability of benefits and a measure of inflation protection. We have not had an opportunity to complete our study on this option. Much, of course, would depend on the type and level of thrift plan proposed. We do however maintain an open mind about the subject and will address the subject more comprehensively when more complete studies are available.

FINANCING

The financing of the current Civil Service Retirement System is comprised of an employee contribution equal to 7% of their basic pay, a matching 7% contribution from the agency, interest from the trust fund assets and direct appropriations from the U.S. Treasury. PL-91-93 authorizes the automatic transfer of funds from the Treasury to the CSRS trust to cover certain revenues. Thus a yearly appropriations from Congress is not supplied except to approve the matching agency contribution contained in that year's agency budget.

In addressing the financing for a supplemental plan, NAGE believes two principles must be complied with - First, the manner in which a supplemental is funded must not jeopardize the benefits already accrued by current participants in CSRS. The first priority we believe must be to assure that the current retirement system is safeguarded. Secondly, the funding to the supplemental must be insulated as much as possible from yearly partisan political debates over the budget.

In conclusion we would like to thank the Committee once again for this opportunity to present our views on the supplemental retirement plan. We look forward to working with the Committee on these important issues in the months ahead.